

Track Records of the Future

Marlee-Jo Jacobson ©

This month we'll describe how to sensibly evaluate an investment with no track record. More important, consider using this evaluation method to appraise investments that DO have track records.

We'll begin with a quote from Dr. Wayne Dyer's new book called "A Spiritual Solution to Every Problem".

"We are subject to many illusions in our daily life. The greatest one is the one that keeps us trapped in giving our energy to what always has been. This illusion is characterized by the belief that; " The past is the reason why I am continuing to believe in these ways." In some of my earlier writing, I have referred to the wake of a fast moving boat. A wake is the trail that is left behind and nothing more, just a trail behind the boat. You don't need to be a nuclear physicist to understand that a wake does not drive the boat. Wayne Dyer - A Spiritual Solution for Every Problem Pg. 83

Not only is past performance evaluation a wake behind the boat, it may be created with murky water. Relying on a wake that may be formed by murky water as our "guiding light" seems a bit tragic - yet that's all we really do!

Let me quantify when I perceive it safe to even look at an investment with no track record. Carefully evaluate the people and how they deal with negatives (things most people choose to hide).

This article was inspired by conversations with Mark. He spent the past couple of years building a new trading strategy called Prime Allocation. Mark has been successfully trading German Bond option spreads for the past three years. His trading experience extends another six years. He traded his own account directly from the exchange floor.

Mark recently said: " Prime Allocation is ready people are telling me I need a track record. I'll start trading my own money in January, but that won't give Prime Allocation a monthly track record. How can it have a track record if it's new? "I'm sorry" he said - but new things do not have track records, there is nothing I can do about that. Come back to me in three years and we'll have a track record."

One needs direct experience with Mark to enjoy listening to him express the problem and the pleasure I derive from co-developing a solution with him.

We decided to use our standard due diligence format integrated with a SafeMoneyMetrics™ strategy designed to evaluate individual trade data rather than monthly performance. The SafeMoneyMetrics™ strategy builds account value trade by trade for each market and the composite performance. We need thirty-six trades or data-points for valid statistical analysis. Our track record will be initiated using individual trade data rather than composite past performance, as time passes individual trade data will naturally flow into a traditional past performance track record.

Anyone can see that SafeMoneyMetrics™ Ratios applied to individual trade evaluation increases risk management. Time is contracted and errors are brought to light so they can be eliminated at the level of cause. It's a superior strategy because it can prevent or minimize the following.

- Composite performance evaluation easily conceals trading mistakes. (Since trading is only a discipline, potential for self-deception related to current reality is also increased. Self-deception for any trader can be THE most devastating factor related to managing money)
- Intra-day volatility and realized profits remain veiled when evaluating month end composite data.
- Because traditional composite performance evaluation does not reveal actual trades, direct capital at risk relative to return cannot be accurately calculated.
- Traditionally after an advisor reaches NEW LOWS and heavy losses occur - people react by either changing advisors or closing the account. A new advisor pays the price. Even emotionally well-adjusted clients will naturally exaggerate any financial draw down that the new advisor has. A negative spiral of events tailspins possibly causing severe financial and emotional losses to everyone involved.

For Mark our volatility ratio can be calculated using open trade equity intra-day. Open trade equity is also evaluated relative to the daily settlement price of each market traded and summarized calculate the composite portfolio.

We'll build a "Prime Allocation" risk management strategy on www.sanctity.com and update it weekly so people can see how the past unfolds relative to what they can expect in the future as described by the due diligence. Mark will also build his own model for Prime allocation.

The due diligence cannot tell anyone what happened in the past - however it will notify people what to expect in the future. We decided that creating a "benchmark" for future expectations was more important than talking about something that already

happened for other people and what would never happen for their account anyway!

The quick mood change in Mark made my day! He was happy with what he got therefore what he could give. Mark's SafeMoneyMetrics™ strategy also gives him instant feedback to the quality of trades relative to current market conditions – he'll also have an impeccable research tool that can consistently seek high quality trades for possible duplication. Weaker trades can also be quantified and eliminated. More important he can evaluate the quality of his initial decisions for each trade relative to results, consistently seeking to maintain or improve his "trading game relative to current market conditions". The positive spiral described becomes an integrated risk management strategy that benefits all people involved at lower cost and risk.

"True nobility is not being better than anyone else, it is being better than you used to be." Wayne Dyer

In November 2001, Daniel told me that the Stark 300 CTA Index lost \$1.38 Billion representing 6.4% of the Indexes total \$21 billion value. (The industry manages over \$40 billion). This represents only one month and it's insignificant relative to the entire industry. However, when losses are personalized and a drawdown extends several months advisors, sponsors and clients suffer.

We perceive that SafeMoneyMetrics™ can help all people use inherent uncertainty and volatility within the futures industry to their advantage rather than be victimized by it!

People can choose or not choose an investment based on information they see in our SafeMoneyMetrics™ model relative to how comfortable they are with what the due diligence quantifies and explains to them. The due diligence and SafeMoneyMetrics™ becomes a "guiding light" rather than a heavy reliance on past performance.

From a sponsor's viewpoint – we can allocate a small portion of a specific fund to Prime Allocation without incurring much risk. People can also directly invest in the Prime Allocation Fund with Mark. If Mark's self-imposed standards described in the due diligence remain unfulfilled, he'll remove himself from trading money. Our entire risk management team is happy because they are relieved from the decision of what to do when a trader violates his own standards.

Our simple solution achieves several important objectives.

- Unnecessary fear and anxiety is directly removed from several people. A positive impact immediately surges through the immediate environment.
- Our potential clients have increased risk control at lower cost and risk than what evaluating past performance alone traditionally offers.

- People can claim that Prime Allocation has more risk because it has no track record. They are 100% correct when viewing the situation from a traditional conditioned perspective. However, Prime Allocation can also be perceived as having less risk than most investments with a track record because we set higher standards for capital at risk relative to return. We also have higher standards for continual risk management. Allocating at least a small portion of a portfolio to a limited risk investment can almost seem harmless.
- Three people in the futures industry are happy! That's alone is a miracle!

"The greater danger of most of us is not that our aim is too high and we miss it, but that it's too low and we reach it." Michelangelo

People are conditioned to view past performance and statistical analysis based on past performance as THE ONLY criteria for choosing an investment. This conditioning is A MAJOR CAUSE for potential disappointment. People forget to evaluate the process of how past performance was achieved. The strategy we designed for Prime Allocation consistently manages and evaluates a complete and continual integrated trading, risk management, marketing, and compliance process. Different aspects of the exact strategy works for the trader, sponsor, and clients at lower cost and risk.

"If you are facing in the right direction all you need to do is keep on walking." Buddhist Proverb

A Complete Due Diligence

Traditionally sponsors perform a due diligence on any managed futures and options investment they offer. I always wondered why the information was never used as a marketing strategy when so much good can come from the process. We thought you would have interest in what our due diligence asks of a trader.

Section One – Data

Data is used to build internal risk management and define future expectations. The numbers do not have to come from past performance. You can use test results. Quantify where the information came from and be prepared to integrate realized trading results as time passes. We use "Internal Benchmarks" .An internal benchmark is a mutually agreed upon self imposed performance standard. The difference between the benchmark and current performance is what matters. Information is also reformatted as a partial marketing strategy. PLEASE INCLUDE A 13 COLUMN TRACK RECORD WITH ACCOUNTING EXPLANATIONS WHEN AVAILABLE.

Data Table # Part 1	NFA ID #
Trading Summary	
Account Size Required:	
Minimum Funding Level:	
Strategy Starting Date:	
Range of Equity Committed to Margin: % TO %	
Approximate # of Trades Per Month for each \$ Unit:	

of Contracts Traded Annually (Per Million):
Percent of Profitable Trades:
Average Profit: Average Loss:
Largest Profit: Largest Loss:
Largest String of Losing Trades: # of Trades Total Dollars:
of Markets Traded:
Worst Monthly Loss (CFTC Defined): Worst or Longest Draw-down % Draw down Duration (Months): Time to New Highs:

Section Two – Risk Management

1. What are your annual financial objectives?
2. What type of strategy do you trade?
3. What markets do you focus in?
4. Is the exact strategy applied to all markets?
5. Do you use multiple systems in each market? (If so, how is capital allocated to each system and market within the strategy)
6. What mathematical parameters did you use to calculate your required account size?
7. How did you determine different acceptable funding levels?
8. What if any discretion is used?
9. What if any fundamental analysis is applied?
10. What if any independent research is integrated?
11. What "time frames" do you apply? Average time of profitable and losing trades:
12. How often is the strategy upgraded and what prompts the alterations?
13. If you trade multiple markets (MPT Style) - How do you monitor your drawdowns? By individual market, the composite, individual trade analysis, other please describe.
14. How do you monitor the efficiency of your strategy relative to current market conditions?
15. Is the person making the trading decisions been the same throughout the length of the track record?
16. How many programs do you offer, what are their account sizes and market selections?
17. How many trades for each program can I expect monthly and how are trades entered and allocated?
18. What are your risk return requirements? (Thank you Holliston Hill!) (Expressed either per trade, margin committed or as a percent or equity.) For example: Do you have ratios for trade selection that express actual capital at risk relative to profit potential of the trade? Please describe:
19. How much capital do you want to manage and how much equity can your current strategy manage without affecting performance?
20. How will clients be notified if strategies are changed?
21. What is the maximum draw down a client should be prepared to live with for each account size you trade? (Does not have to be related to past performance)
21. **A)** what is the maximum intra-month draw-down your worst account has experienced?
21. **B)** what is the approximate percentage loss of the maximum intra-month drawdown over the maximum month end drawdown for the worst account?
21. **C)** what is the fully funded account size of the maximum drawdown's expressed in # 21 a & b?
21. **D)** what is the actual funding level of the account size expressed in #c?
22. How long should I commit my capital without making money before giving up on you?
23. Under what market conditions do you not make money?
24. How does your strategy adjust to changing market conditions, particularly a major increase in volatility?

25. Does your strategy stand aside or it is always in the market? Please describe.
26. What would prompt you to completely halt trading and stand aside?
27. How are new accounts entered into already existing positions? New Positions?
28. How does the program exit markets?
29. How does it exit from profitable positions?
30. How does your strategy protect unrealized profits?
31. Do you track equity peaks in unrealized profits to market exits?
If so, do you monitor the ratio or loss from a high until the strategy exits the market?
32. Does your strategy adjust to current market conditions or do you need current market conditions to adjust to what your strategy is?
33. How are you prepared for catastrophic moves?
34. What is a financial standard for trade selection? For example: Do you require a risk/reward potential for trades before they are taken? Please describe any REAL capital at risk relative to profit potential standards that are built into your strategy. Ideas to stimulate your self-expression are included below.
 - Transaction costs relative to anticipated profit per trade -
 - Margin - Percent of Account Equity - Risk to Potential Reward per trade ratios
 - Maximum allowable loss per month
 - Maximum allowable loss per trade relative to percent of profitable trades - relative to profit to loss ratio of total number of trades.
 - Ratios that monitor profit to losses and possible changes for each market.
 - Maximum percent of equity to risk if equity drops 5%, 10%, 15% above 15%
 - Maximum peak to valley draw down -Maximum allowable standard deviation of monthly returns for each market and the composite portfolio. Tracking error that measures peak performance of the strategy relative to current reality.
35. What percent of total capital is risked on each market sector at any one time? Are the allocations within each sector allocated to each market relative to any particular thought process? Please describe:
36. How does account size affect capital management strategies? For example: If someone gives you \$500,000 and someone else \$1 Million does the \$1 million get double what the \$500,000 trades or are there other differences?
37. What modifications do you make in your trading strategy/systems when in a draw down?
38. Do you trade with stop loss, MIT, market orders or other, what are your principles regarding stops?
39. Explain your concept pro/con regarding diversification?
40. How are options used with your strategy?
41. What was the average fee structure that your track record was calculated at?
42. What was the average commission to equity ratio the track was calculated at?
43. What percent of monthly return belongs to interest earnings?
44. Has your track record been recalculated because of NFA intervention? If so what was required of you?
45. Is your 13 column calculated by an accounting firm or in house?
46. What mathematical distortions do you perceive exist between the method of track record calculation required by the CFTC and the truth of what an investor can expect? What would you tell an investor that would increase his comfort and can rectify the natural distortion?
47. What percent of actual capital on a fully funded account is REALLY at risk at any one time using your strategy? An average range will suffice!

48. What questions would you add to this list if you were sponsoring this service to clients?
49. Why would someone entrust you with his or her money, rather than with another advisor?
50. Understanding that what can go wrong may be perceived as negative, in derivatives, we consider high intelligence an ability to consider and prepare for it. Have you considered the absolute downside, how it can happen, and prepared for the potential event? Briefly, describe.
51. Do you have a bias for the long or short side of a market?
52. Have you ever analyzed your trades to see if a bias exists? If so what were the results?

Section Three - Discipline and Business Risk Management

1. What is your weakest point when trading?
2. How do you manage stress daily?
3. What other means of support do you have other than managing client funds?
4. Do you trade your own account and how is it traded differently than client funds?
5. What do you most frequently screw up relative to your business, and how do you adapt to the crummy habit?
6. Who manages all administration and client service within your company?
7. How much do you believe administration takes away from your time needed with markets?
8. Do you have any programs that were closed? If yes, please add length of program before it closed. How much capital was managed? Why did you close?
9. Do you compensate any third party, unrelated to Sanctity when we market your services? If YES Who and how much?
10. Do you share in incentive fees, if so under what circumstances and how much?

Section Four - Philosophical Questions

1. Understanding that past performance is useless - what guidelines do you use to determine your future goals?
2. What "early warning" indicators are built into your strategy?
3. Where do you believe your perceptions are inaccurate and how do you compensate?
How do you feel about "fear as a motivator" or driver of energy if it motivates your trading? Or your diversification strategy? For example: fear of opportunity loss, fear of disaster, and fear of losing your mind or whatever else you fear.
4. What do you believe motivates you relative to being a money manager?
5. How would you like to be known to the marketplace?
6. What values are important for you to give and expect to have honored from the marketplace?
7. What is your greatest fear relative to managing money? What have you done to diffuse the energy or deal with the fear in practical terms?
8. What do you love doing most of all?
9. What do you still do that you loved as a child?
Alternatively, what has been consistent throughout your life that has sustained you from a point of just loving to do it? (Self-Expression what makes you happy!)?
10. What triggers your darker side and how do you deal with it?
11. What do you expect from Sanctity relative to the quality of accounts we develop?
12. Is there anything special we can do for you to make your life easier?

In Conclusion –

Our electronic SafeMoneyMetrics™ strategy for Prime Allocation will be ready when Mark completes his share of the work – we'll notify everyone when it's completed. www.sanctity.com will then have a direct link from the cover called A Prime Allocation Investment.

Limited Risk Investments for All People

This month we began building limited risk investments for all people. Increments begin at \$5000 and have unlimited upside. We have enough feedback to fill a need for financial professionals, accredited investors, and mere mortals such as myself.

We also offer FREE exempt limited partnership KITS for friends and family – For example- assume you are an investment club – or you and a few friends want to dilute risk by combining your financial resources. We'll provide you with a FREE limited partnership document that even includes software for your accountant - We ask that your partnerships be allocated into investments built by Sanctity Capital Management / and that all investments always use SafeMoneyMetrics™ WHY?

All people are entitled to an equal superior opportunity at lower cost and risk – We hope the project is fun and profitable for everybody!

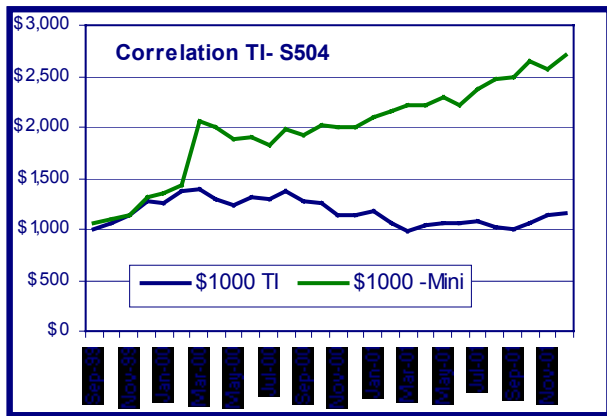
Sanctity Partners -Mini Index Strategy

Sanctity Partners S504 – Mini Index Strategy can be used as a limited risk partnership, managed account, or trading manager strategy. Rather than only accommodating accredited investors, we accept money from all people. Partnership investments begin at \$5000, managed accounts \$35,000 and trading manager services integrating more than one advisor \$150,000

The data table below represents an equally weighted \$1000 hypothetical unit allocated to a traditional index of the S&P 500, NASDAQ Composite, Russell 2000 and the Lehman Bond Index. Then 20% was reallocated to the S504 Mini Index, and finally 100% of the \$1000 allocated to the S504 Mini Index.

Annual Return Table			
	100% TI	80-20	100% Index
4 Mos 1999	28.87%	27.77%	23.66%
2000	-11.39%	1.55%	52.01%
2001	1.93%	9.93%	35.05%
Total	19.41%	39.25%	110.72%
SP 504 Added		8.00%	91.31%

The correlation chart below chart represents a hypothetical \$1000 hypothetical unit allocated to the Traditional Index and a hypothetical \$1000 unit allocated to S504 Mini Index. You can clearly see how the performance of both investments remains independent of each other.



LAST BUT MOST IMPORTANT

A friend of mine was an inter-bank trader, his brother a cash bond trader. They are currently partners and self-employed investment bankers in Little Rock Arkansas – David once said - “Marlee-Jo – I know at the end of every day that the most important thing I have to do is love my brother.”

Happy and Healthy New Year W/Love From Us!

Sanctity is a team of prominent industry professionals. We offer business development, consulting risk and asset management services in managed futures and options. Services are all private label and integrate [SafeMoneyMetrics™](#), a proprietary risk management strategy.

Investments offer limited risk and have no out of pocket costs

Marlee-Jo Jacobson -212-777-3862
sanctityone@msn.com
<http://www.sanctity.com>

Intentionally Left Blank